

INITIAL STATEMENT OF REASONS

Proposed Amendments to Sections 588.1 and 588.2 for Risk Pooling Regulations

Description of Public Problem, Administrative Requirement, or Other Condition or Circumstance that the Regulation is Intended to Address: Since 2003, the Board has had authority to create, combine or eliminate risk pools for local miscellaneous and local safety members. The Board may establish by regulations, the criteria under which contracting agencies, including school employers that choose to contract as public agency employers, may participate in risk pools.

Beginning with the June 30, 2003 actuarial valuations, plans with less than 100 active members have been mandated into risk pools based on their benefit formula and membership category. There are currently 10 public agency risk pools.

Currently, Government Code Section 20840(e) requires that each risk pool must contain the following benefits:

- Pre-retirement Optional Settlement 2 Death Benefit (Section 21548)
- Credit for Unused Sick Leave (Section 20965)
- Public Service Credit for Periods of Layoff (Section 21022)
- Public Service for Peace Corps or AmeriCorps: VISTA Service (Section 21023.5)
- Military Service Credit as Public Service (21024)
- Public Service Credit for Service Rendered to a Nonprofit Corporation (Section 21026)
- Military Service Credit for Retired Persons (Section 21027)
- Local System Service Credit Included in Basic Death Benefit (Section 21536)
- Cancellation of Payments for Service Credit Purchase Upon Industrial Disability Retirement (Section 21037) (Mandated for all contracting agencies effective 1/1/2004)

Current regulations require any existing contracting agency with a rate plan of less than 100 active members on any annual actuarial valuation date to participate in a risk pool. For such rate plan, the sharing of risk resulting from participating in a risk pool begins on the day after the date of the actuarial valuation. For an employer required to participate in a risk pool based on the June 30, 2007 actuarial valuation, risk is being shared beginning on July 1, 2007. However, the date a rate plan starts participating in a risk pool and shares risk with other rate plans of the same pool is different from the effective date of the pool's mandated benefits (except where the contracting agency employer already

includes the mandated benefit for its employees in its existing CalPERS contract.)

Because of the complexity and the amount of time needed to obtain the information for each individual participant that is required to perform an actuarial valuation, there currently is a two year lag for public agencies between the valuation date of an actuarial valuation and the effective date of the new employer contribution rates established by that valuation. For example, the June 30, 2007 actuarial valuations that were recently completed by the actuarial staff were used to establish the employer contribution rates for fiscal year 2009-2010.

The proposed amendment to regulation 588.1 would codify the existing practices and clarify that even though an employer (whether a new contracting agency or an existing contracting agency) begins sharing the demographic risk with other plans of the same risk pool as of the date that participation is mandated, the mandated employee benefits not already offered by the employer to its employees will become available to employees only when the employer's contributions to the risk pool reflect the increased costs of the benefits. Thus, in accordance with current time frames, employees of an employer that are required to join a risk pool on June 30, 2007 would not be covered by the risk pool's added mandated benefits nor would the employer begin to contribute toward the risk pool's added mandated benefits until July 1, 2009.

In addition, current regulations require participation in a risk pool by new contracting agencies if the agency has less than 100 active members at the time of the initial actuarial valuation. This absolute requirement to participate in a risk pool may prove detrimental to existing contracting agencies in a pool if the new contracting agency's retirement benefit costs are significantly higher than those of the pooled agencies. If the new agency's costs are higher than costs of employers in the pool, the employers in the pool will be harmed because they will be paying increased contributions covering amounts for which the new contracting agency was previously responsible.

Specific Purpose: The proposed amendments to sections 588.1 and 588.2 are intended to meet the requirements of Government Code Section 20840. The proposed changes in section 588.1 clarify the effective date of the pool's mandated benefits for contracting agencies participating in risk pools. The proposed changes in section 588.2 give CalPERS the authority to place a new contracting agency in an individual non-pooled plan rather than in a risk pool if CalPERS actuarial staff deems it necessary to protect pooled employers from potential unfavorable additional costs attributable to new contracting agencies.

Necessity: The proposed amendment to regulation 588.1 would codify the existing practices and clarify that even though an employer begins sharing the demographic risk with other plans of the same risk pool as of the date that participation is mandated, the added mandated employee benefits will become

available to employees only when the employer's contributions to the risk pool reflect the increased costs of the benefits.

This is not a change from existing practices. The approach has been used since the implementation of pooling. Attempting to make mandated benefits effective as of the date of the actuarial valuation is impractical because twelve months or more elapse between the valuation date and completion of the actuarial valuations when CalPERS first becomes aware that the active member count has fallen below 100 active members (i.e. the actuarial valuations as of June 30, 2007 were completed in October 2008). Making the effective date of the mandated benefits the date of the actuarial valuation would require the pool's mandated benefits to be administered retrospectively causing great administrative difficulty. Meanwhile, the contracting agency is not required to start making contributions for the mandated benefits until the start of the following fiscal year.

For ease of administration of risk pools and fairness among all employers of the same risk pools, changes to section 588.1 are needed to codify current practices and to clarify the Mandated Benefit Effective Date for plans participating in the risk pools as the first day that the contracting agency is required to pay for the mandated benefits.

The proposed amendment to regulation § 588.2 is needed to provide an exception to the requirement that new contracting agencies with less than 100 active members would be mandated to join a risk pool for the reasons set forth below.

Recently, the Actuarial Office has performed new contracting agency actuarial valuations for employers currently participating in a 1937 Act County Retirement System. As a result of different actuarial assumptions applied by CalPERS, some of these valuations have revealed that the new contracting agency's employer contribution rates were significantly higher under the County Plan than they would be under CalPERS. These dramatically different employer contribution rates given by CalPERS and other retirement systems result from application of different actuarial assumptions to actuarial valuations.

Generally speaking, it takes several years to identify a plan's true experience on salary growth and various decrement rates. For example, a new group may have a very different salary scale compared with CalPERS plans. Therefore, for the purpose of protecting pooled employers from additional costs attributable to new contracting agencies, avoiding potential dispute by new contracting agencies, preserving the actuarial soundness of risk pools and easing the administration of risk pools, changes to § 588.2 are needed to allow CalPERS actuarial staff to deny participation in a risk pool if the actuary finds that participation would be unfavorable to the pool and its participants. Upon a finding that participation

would be unfavorable, the matter may be referred to the CalPERS Board for a hearing for determination.

The proposed amendment adds the same language that already is included in Regulation § 588.3 relating to optional participation by contracting agencies with 100 or more employees.

Technical, Theoretical and/or Empirical Studies, Reports or Documents:
Not applicable.

Alternatives to the Regulatory Action and CalPERS' Reasons for Rejecting Those Alternatives: CalPERS has considered alternatives to this proposal, and has determined that there is no more effective way to carry out its purpose that would be less burdensome.

Alternatives to the Regulatory Action that Would Lessen any Adverse Impact on Small Businesses: The proposed action has no cost impact on small businesses because it applies only to public agency employee retirement benefits.